

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

BRENDA SCHISLER

CASE NO. 07-61319

Debtor

Chapter 7

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

**MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER**

Presently before the Court is a motion filed by Nathan M. Goldberg, chapter 7 trustee ("Trustee"), on July 24, 2007, seeking disgorgement of fees and also production of certain documentation in the case of Brenda Schissler ("Debtor"). The motion was served on Thomas DeLorenzo, Esq. ("T. DeLorenzo") of the DeLorenzo Law Firm; Ryan & Smallcombe, Esqs.,

Liberty Mutual Insurance Co., Michael J. O'Connor, Esq. ("O'Connor"), the Debtor and the Office of the United States Trustee ("UST"). Opposition was filed by Richard H. Weiskopf, Esq. ("Weiskopf") on behalf of the DeLorenzo Law Firm on September 6, 2007. On September 7, 2007, opposition was filed by David T. Luntz, Esq. ("Luntz") on behalf of Ryan & Smallacombe, PLLC, attorneys for Athens Associates.

The motion was heard at the Court's regular "CourtCall" motion calendar on Tuesday, September 11, 2007.¹ Following oral argument, the Court requested that a supplemental affidavit on behalf of the Delorenzo Law Firm be filed by October 4, 2007. The matter was placed on the Court's calendar for October 9, 2007, with the understanding that the Court would notify the parties if further appearances would be necessary. The motion was submitted for decision on October 9, 2007, without further appearances or oral argument.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this contested matter pursuant to 28 U.S.C. §§ 1334(b), 157(a), 157(b)(1), (b)(2)(A), (E) and (O).

FACTS

¹ This case was originally filed in the Albany Division of the U.S. Bankruptcy Court, Northern District of New York (Case No. 00-13469). Pursuant to an Order of the Court, it was transferred to the Utica Division on March 6, 2007 (Case No. 07-61319) as a result of realignment of the District following the appointment of the Hon. Margaret Cangilos-Ruiz as bankruptcy judge for the Syracuse Division. Effective April 1, 2007, the Utica Division authorized the telephonic appearance at motion calendars using CourtCall for debtors residing in St. Lawrence, Franklin, Montgomery and Fulton Counties in the State of New York.

The Debtor filed a voluntary petition pursuant to chapter 7 of the U.S. Bankruptcy Code, 11 U.S.C. §§ 101-1532 (“Code”) on June 21, 2000. Listed as personal property in Schedule B of the petition under the heading of “Other contingent and unliquidated claims of every nature,” was a claim against Athens Associates and against “Workers Compensation,” both in unknown amounts. According to the Trustee, at the First Meeting of Creditors on August 8, 2000, the Debtor disclosed that she had commenced an action in New York State Supreme Court, County of Albany (“State Court”), against Athens Associates and Plattsburgh Plaza Associates in connection with a slip and fall on February 3, 1997. *See* Trustee’s motion at ¶ 3 and Exhibit A, attached to Affidavit of Luntz, sworn to September 7, 2007 (“Luntz Affidavit”). Debtor was represented in the State Court action by Paul E. DeLorenzo, Esq. (“P. DeLorenzo”) of the law firm of DeLorenzo, Pasquariello, Weiskopf, P.C.²

According to the Trustee, he wrote P. DeLorenzo in June 2002, approximately two years after the chapter 7 case had been commenced, asking for his input regarding the State Court action and the potential for a recovery in excess of the Debtor’s personal injury exemption. *See* Trustee’s Exhibit C. In the letter, dated June 3, 2002, the Trustee explained that payment for any services performed on behalf of the Trustee in connection with the State Court action would require prior approval of the Court and any distribution to be made to the Debtor would require the same. *Id.* On August 5, 2002, the Trustee filed an application to employ the DeLorenzo Law Firm, LLP as Special Counsel. According to the affidavit of P. DeLorenzo, in connection with the employment of his firm to represent the Trustee “in pursuit of his equity in this asset of the

² At the hearing on September 11, 2007, Weiskopf indicated that he had left that law firm in August 2001.

estate,” he was “aware that the payment of my fees and disbursements shall be subject to final approval by the Bankruptcy Court.” *See* Exhibit B, attached to Trustee’s motion. On October 23, 2002, the Court signed an Order granting the Trustee’s application. *See* Exhibit A, attached to Trustee’s motion. The Order provides that “special counsel shall provide at least twice each year, written status report to the Trustee of the matter upon which they have been retained, or more frequently if requested by the Trustee . . . [and] that no fees or expenses will be paid to the special counsel, including the use of any retainer received for post-petition services, without prior approval of the Court.” *Id.*

According to Luntz, who represented Athens Associates, after “protracted discovery and motion practice,” the matter was scheduled for trial on December 5, 2005. *See* Luntz Affidavit at ¶ 4. According to the Supplemental Affidavit of P. DeLorenzo, sworn to on September 18, 2007, he contacted the Trustee on December 5, 2005, to discuss a proposed settlement. Based on his conversation with the Trustee, he represented to the State Court that the Trustee would accept a settlement offer of \$75,000, with \$25,000 being paid up front and the balance of \$50,000 being structured. *Id.* The transcript from the hearing in State Court before the Hon. Judith A. Hard, Acting Supreme Court Justice, placing the settlement on the record, indicates that P. DeLorenzo stated:

I have contacted the bank [sic] trustee, Nathan Goldberg, who we all talked about in chambers who gave me permission to go ahead and proceed with this as long as a certain amount down takes care of the creditors which we’ve already discussed that we will cover that, the original Worker’s Comp lien. They’ve given me an understanding of how that was settled as well and I’m working through the figure with them in time.

See Exhibit C at p. 3, attached to Luntz Affidavit.

By letter dated December 7, 2005, to P. DeLorenzo, the Trustee indicated that “I would

be willing to recommend to the court such a settlement arrangement. In order to settle the case, it would be necessary for me to obtain an order of the court authorizing the same. Please let me know if this can be arranged.” *See* Exhibit A, attached to DeLorenzo Supplemental Affidavit. Neither party has provided the Court with any evidence of a response to the Trustee’s letter.

At the hearing before this Court on September 11, 2007, Weiskopf indicated that the State Court action was not actually “resolved” until January 2007 because of ongoing discussions with the Workers’ Compensation carrier, Liberty Mutual Insurance Company.³ A letter dated December 16, 2006, from T. DeLorenzo to Luntz requests that a check be issued to Liberty Mutual Insurance Company in the amount of \$44,484.09 in full payment of the workers’ compensation lien, pursuant to a fax of November 20, 2006, from Liberty Mutual Insurance Company. *See* Exhibit E, attached to Luntz Affidavit. “The balance of the funds can be made payable to our firm and to Brenda Lazarou [Schissler].”⁴ *Id.* On or about January 12, 2007, a check was issued to Liberty Mutual Insurance Company and a second check was issued to the DeLorenzo Law Firm in the amount of \$22,242.05.⁵ *See* Exhibit F of the Luntz Affidavit.

In the interim, the Trustee allegedly had written to P. DeLorenzo on or about June 13,

³ According to the Statement of Settlement, the date of settlement was listed as May 31, 2006. *See* Exhibit B, attached to Response on behalf of the DeLorenzo Law Firm, dated Sept. 6, 2007.

⁴ At the hearing on September 11, 2007, it was represented to the Court that the Debtor had been paid \$5,000 toward her personal injury exemption. O’Connor, Debtor’s bankruptcy attorney, indicated that he was appearing in order to protect her exemption of \$7,500. The Court commented that there was neither an affidavit nor a cancelled check suggesting that she had actually been paid even the \$5,000.

⁵ According to the Statement of Settlement, the DeLorenzo Law Firm was actually paid \$22,766.71 in fees and \$7,749.20 in disbursements. *See* Exhibit B, attached to Response on behalf of DeLorenzo Law Firm, dated Sept. 6, 2007.

2006, asking that he review the Trustee's application to the Court for approval of the settlement, as well as payment of his fees and disbursements. *See* Exhibit C, attached to Trustee's motion. According to a letter dated May 24, 2007, to P. DeLorenzo, the Trustee indicated that he had not received a response to his prior letter of June 13, 2006 and he was being asked by the UST to report to the Court on the status of the case. *Id.* The motion now under consideration by the Court was filed on July 24, 2007.

At the hearing on September 11, 2007, the Trustee indicated that there was only one creditor in the case. A review of the docket, indicates that a Notice of Asset Case, dated June 23, 2004, was filed by the Trustee (Dkt. No. 13). According to the Final Notice of Deadline to File Proofs of Claim, dated December 5, 2005, the last date to file proofs of claim was March 6, 2006 (Dkt. No. 16). Although the Debtor listed fourteen creditors holding unsecured claims totaling \$2,001,976⁶ (*see* Schedule F, attached to Debtor's petition), only Providian National Bank, filed a proof of claim on June 15, 2006, in the amount of \$1,571.73.

DISCUSSION

The filing of a bankruptcy petition and the commencement of the case creates an estate comprised of all the legal and equitable interests of the debtor in property. 11 U.S.C. § 541.

⁶ One of the claims listed in Schedule F is a claim of \$2,000,000, allegedly owed to Holly and Michael Palleschi.

Prepetition personal injury claims, as well as the settlement proceeds from such claims, are property of the bankruptcy estate. *In re Turner*, 274 B.R. 675, 678 (Bankr. W.D. Pa. 2002); *In re Cooper*, 263 B.R. 835, 837 (Bankr. S.D. Ohio 2001). In a chapter 7 case said assets are under the custody and control of the chapter 7 trustee. It is the trustee who has the authority to prosecute, defend and settle any lawsuit pending at the time of the bankruptcy filing. *In re Flanagan*, Adv. Pro. Nos. 04-5638, 06-0731, 2007 WL 2915812, at *5 (2d Cir. Oct. 9, 2007); *In re Mercury*, 280 B.R. 35, 58 (Bankr. S.D.N.Y. 2002), *aff'd*, 122 Fed.Appx. 528 (2d Cir. 2004). As is often the case, a trustee will apply to the Court for permission to retain the debtor's attorney handling the personal injury litigation as special counsel to the Trustee to prosecute or settle the claim in another forum. Furthermore, any settlement of the litigation must be approved by the Court. *Flanagan*, 2007 WL 2915812, at *5.

In this case, the Trustee sought the appointment of the DeLorenzo Law Firm as special counsel on August 5, 2002, after making it clear that the law firm's fees and disbursements would be subject to final approval by the Court. That direction was repeated in the Order appointing the DeLorenzo Law Firm, dated October 23, 2002. So too by letter dated December 7, 2005, the Trustee again reminded the DeLorenzo Law Firm that any settlement of the State Court action was also subject to final approval by the Court.

Code § 362(a)(3) prohibits the exercise and control over property of the estate. By proceeding with the settlement and directing that the proceeds be disbursed to Liberty Mutual Insurance Company and to the DeLorenzo Law Firm without either Trustee or Court approval, the DeLorenzo Law Firm violated the automatic stay. As one court noted,

[a]ny distribution of property must be by the trustee after he has had an opportunity to familiarize himself with the various rights and interests involved

and with the property available for distribution. To achieve this purpose the stay of (a)(3) is very wide in terms of the conduct that is covered.

In re Stinson, 221 B.R. 726, 730 (Bankr. E.D. Mich. 1998), quoting 1 David G. Epstein et al., *Bankruptcy*, § 3-14, at 162 (1992); *see also In re Pace*, 159 B.R. 890, 900 (9th Cir. BAP 1993), *aff'd in part, vacated in part on other grounds*, 67 F.3d 187 (9th Cir. 1995) (noting that “attempts to direct or control the proceeds of the settlement . . . were in clear violation of the automatic stay”). As pointed out by the court in *Cooper*, an attorney who has knowledge of the bankruptcy and then exercises control over settlement proceeds during the pendency of the case is liable for the full value of the proceeds “even though such proceeds were no longer under his control at the time of the trustee’s demand for turnover.” *Cooper*, 263 B.R. at 838. “The only defense of which the attorney may avail himself is the defense of lack of notice and actual knowledge of the bankruptcy provided by § 542(c).” *Id.* (citation omitted). In this case, it is clear that the DeLorenzo Law Firm had notice of the Debtor’s bankruptcy when it agreed to serve as special counsel to the Trustee in connection with the State Court action and when it directed disbursement of the settlement proceeds in clear violation of the automatic stay.

Not only has the DeLorenzo Law Firm willfully violated the automatic stay, it has also willfully and knowingly violated an Order of this Court. Such a violation of a valid order of a court having jurisdiction over the subject matter constitutes civil contempt. *In re Cherry*, 247 B.R. 176, 186-87 (Bankr. E.D. Va. 2000). The Court’s Order of October 23, 2005, expressly provided that “no fees or expenses will be paid to the special counsel . . . without prior approval of the Court.” Not only did the DeLorenzo Law Firm fail to seek the Court’s prior approval of the settlement, it also failed to seek the Court’s prior approval of its fees and disbursements. Pursuant to Code § 105, the Court has been granted broad powers to implement the provisions

of Title 11 and prevent abuse of the bankruptcy process. *In re Reath*, Case No. 04-49199, Adv. Pro. 06-1531, 2006 WL 3524458, *6 (Bankr. D.N.J. 2006).

Having concluded that the DeLorenzo Law Firm violated the automatic stay by directing the disbursement of the proceeds generated pursuant to the settlement of the State Court action without prior approval of this Court and also violated an Order of this Court by failing to seek approval for its fees and disbursements, the Court deems it appropriate pursuant to Code § 105 to require the DeLorenzo Law Firm to disgorge the fees paid to it in the amount of \$22,766.71, as well as monies reimbursed for expenses totaling \$7,749.20. *See* Exhibit B, attached to Response on behalf of Delorenzo Law Firm, dated September 6, 2007.⁷

The Court directs the DeLorenzo Law Firm to deposit \$30,515.91 with the Trustee within 45 days of the date of this Order to be held in escrow pending the filing by the Trustee of a statement of his claimed costs and expenses, reasonable attorney's fees and commissions,⁸ disbursements to the Debtor with respect to her exemption claim of \$7,500, if appropriate, and to Providian National Bank on its unsecured claim, for the Court's approval. The Court also directs the Trustee to review the settlement with Liberty Mutual Insurance Company and to provide the Court with an affidavit regarding the appropriateness of the payment to it of

⁷ Although the Trustee in his motion named the law firm of Ryan & Smallcombe, PLLC, which represented the defendant, Athens Associates, in the State Court action, the Court finds no basis to impose sanctions against it. In issuing the checks to Liberty Mutual Insurance Company and to the DeLorenzo Law Firm, it reasonably relied on the representation made by P. DeLorenzo on December 5, 2005, that the settlement had been approved by the Trustee.

⁸ The courts have concluded that a trustee is not an "individual" entitled to recover attorney's fees and costs pursuant to Code § 362(h), but that a trustee may recover damages in the form of costs and attorney's fees under Code § 105(a) for violations of the automatic stay. *See Pace*, 67 F.3d at 193.

\$44,484.09 in satisfaction of the workers' compensation lien, said affidavit to be filed within 45 days of the date of this Order.⁹ In the event that a balance remains in the escrow account after the above disbursements have been approved by the Court, said balance shall be remitted by the Trustee to the DeLorenzo Law Firm in total satisfaction of its fees and costs.¹⁰

IT IS SO ORDERED.

Dated at Utica, New York

this 2nd day of November 2007

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge

⁹ Under the circumstances, the Court does not believe at this juncture that it is necessary to require Liberty Mutual Insurance Company to disgorge the monies paid as reimbursement for workers' compensation paid to the Debtor. Until the Trustee files the requested affidavit, the Court makes no determination regarding disgorgement by Liberty Mutual Insurance Company. It appears that the monies paid to the DeLorenzo Law Firm are sufficient to pay not only the claim of Providian National Bank in full, including interest, but also to pay the reasonable fees, commissions and expenses incurred by the Trustee in connection with his administration of this case, including having to file the motion now before this Court, as well as the Debtor's exemption claim of \$7,500.

¹⁰ While the Court acknowledges that the DeLorenzo Law Firm may contend that the Court's direction that it remit the entire sum of \$30,515.91 to the Trustee is unreasonable, given the very real prospect that the Trustee will ultimately remit a significant portion of that sum back to the DeLorenzo Law Firm, the Court believes that to order otherwise condones the actions of the DeLorenzo Law Firm in not only violating the Code § 362(a)(3) stay but also in flagrantly violating an Order of this Court